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APR 3

No. 758

In the Supreme Court of the United States

OCTOBER TERM, 1935

INTERNATIONAL BUSINESS MACHINES CORPORATION,
APPELLANT

v.

THE UNITED STATES OF AMERICA

ON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR THE UNITED STATES

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OPINION BELOW

The opinion of the United States District Court for the Southern District of New York (R. 380) is reported in 13 F. Supp. 11.

JURISDICTION

The decree of the District Court was entered December 26, 1935 (R. 398). Petition for appeal was filed January 15, 1936, and was allowed on the same day (R. 402, 403).

Jurisdiction of this Court is conferred by Section 2 of the Act of February 11, 1903, c. 544, 32

Stat. 823 (U. S. C., Title 15, Sec. 29), and by Section 238 of the Judicial Code, as amended by the Act of February 13, 1925, c. 229, 43 Stat. 938 (U. S. C., Title 28, Sec. 345).

QUESTIONS PRESENTED

(1) Whether appellant has shown that the tying clauses incorporated in its leases are necessary to protect its good will and, if so, whether this circumstance is sufficient to exclude from the prohibitions of Section 3 of the Clayton Act tying clauses which come within the express terms of that section.

(2) Whether the District Court erred in striking out and disregarding appellant's patents as irrelevant and immaterial to the issues in this case.

STATUTE INVOLVED

Section 3 of the Act of October 15, 1914, c. 323, 38 Stat. 731 (U. S. C., Title 15, Sec. 14), known as the Clayton Act, provides:

> That it shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of goods, wares, merchandise, machinery, supplies, or other commodities, whether patented or unpatented, for use, consumption, or resale within the United State or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, or fix a price charged therefor, or discount from, or rebate upon, such

price, on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies, or other commodities of a competitor or competitors of the lessor or seller where the effect of such lease, sale, or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce.

STATEMENT

This is an appeal from a decree of the District Court enjoining appellant from leasing its tabulators, sorters, and punches (sometimes collectively referred to herein as tabulating machines), upon terms which require its lessees to use in such machines appellant's tabulating cards. Paragraph 2 of the decree, which enjoins appellant from making certain agreements with any competitor dealing in tabulating machines, was entered with appellant's consent and is not in issue in this appeal.

Suit in this case was instituted by a petition in equity charging the defendants with violating both the Sherman Act and Section 3 of the Clayton Act. Of the four original defendants, The Tabulating Machine Company, a subsidiary of appellant, has been merged with it, and Remington Rand Business Service, Inc., has been dissolved (R. 380). The fourth defendant, Remington Rand, Inc. (hereafter referred to as Remington), has agreed

to the entry against it of a consent decree enjoining it from violating, in the manner alleged in the petition, both the Sherman Act and the Clayton Act [1] (R. 41–46, 47).

The United States and appellant, prior to trial, entered into a stipulation providing for the entry against appellant of a consent decree giving appropriate relief in respect of its alleged violation of the Sherman Act (R. 46–47, 71–72). The stipulation also provided that the issues relating to appellant's alleged violation of the Clayton Act should be submitted to the District Court for decision upon the pleadings (other than the affirmative allegations of the answer) and upon the facts stipulated by the two parties (R. 47). The case having been submitted to the District Court upon this basis, it held that the restrictive conditions and covenants incorporated in appellant's tabulating machine leases are tying clauses within the meaning of Section 3 of the Clayton Act and that their effect is "to substantially lessen competition" and "to tend to create a monopoly" in commerce in tabulating cards.

Since appellant does not attack the court's holding that the tying clauses are such as to fall within

[1] The stipulation between the United States and Remington provides that this consent decree shall not be entered until a final decree is entered against appellant and that Remington shall have the right to have the proposed form of decree modified to accord with the decree entered against appellant (R. 42).

the terms of Section 3, it will be sufficient to describe their general character without setting them forth verbatim. Appellant's usual form of lease provides that the lease shall terminate and the lessee shall be liable for the full rental for the unexpired term of the lease if any tabulating cards purchased other than from appellant are used in the leased machines (R. 392–393). When the lessee is the United States, the lease provides for a 15% "increase in the rental of all leased machines" if cards manufactured by the Government Printing Office are used in "any" of the machines covered by the lease (R. 393).

The machines of appellant and Remington are the only ones capable of performing complex statistical tabulations and computations without intervening manual operations (R. 49, 51). In fact, these machines are commonly recognized as being superior in many ways to others which are on the market, and their use by the United States and by many private concerns is a practical business necessity (R. 49).

Appellant manufactures three types of machines, which are used in conjunction with each other, punches, sorters, and tabulators. The punches are used to perforate a small card, known as a tabulating card, so designed that the various locations or relative positions of the perforations indicate numerical or other data (R. 48). The sorting machine is used to separate, sort, or classify tabulating

cards according to the perforations in them in order to segregate or classify all or part of the information represented by the perforations (*ib.*). This is accomplished by means of electrical contacts established through the perforations. When cards thus sorted are inserted in appellant's tabulators, the latter will record, compute, or otherwise register the information denoted by the perforations in the cards (*ib.*). In Remington's sorters and tabulators, the movement of small pins into holes in the tabulating cards brings about, through linkage, similar sorting and assembling or computing and tabulating operations (*ib.*).

With the exception of hand-operated punches, appellant leases, and does not sell, all of its tabulating machines, and this has been its practice for the past 30 years (R. 52).

The cards used in appellant's sorters and tabulators must conform to very precise specifications as to size and thickness, and they must be free from any slime or carbon spots which would cause unintended electrical contacts and inaccurate results (R. 57). The machines therefore require a card of special manufacture (R. 58), but satisfactory paper for the manufacture of such cards is available (R. 59), this paper is not the subject of letters patent or secret processes (R. 53), and others can obtain paper stock from those who supply appellant (*ib.*). The Government Printing Office, employing its own methods and machines, manufactures tabulating cards which "are now being

used in large quantities daily" in machines leased by the Government from appellant and Remington and these Government cards "have been found to be satisfactory" (R. 59–60). The parties have stipulated that it is possible for others than appellant "to manufacture and sell *satisfactory and usable tabulating cards*" (R. 53). The cards manufactured by Remington are mechanically "appropriate for use in" appellant's machines (App. Br., p. 6), but, since Remington has hitherto been barred from selling cards for use in appellant's machines and since Remington machines do not require an electrically tested card, Remington's cards "are not now electrically tested" (R. 60).[2]

The only tabulating machines available for commercial use in the United States which operate by means of perforated cards are those of appellant and Remington[3] (R. 48–49). Accordingly their lessees furnish the only market for tabulating cards and, since appellant and Remington has each restricted its lessees to the cards of the lessor, this market has been closed to all third persons. It

[2] There is a clear implication from the stipulated facts that Remington would not require the use of any patent owned by appellant in order to test electrically cards adapted for use in appellant's machines. The only patent to a paper-testing machine which appellant claims expired on August 27, 1935 (R. 22, 31–32, 56).

[3] Of the machines of this type which are now in use in the United States, appellant owns approximately 85.7% of the tabulators, 86.1% of the sorters, and 81.6% of the punches (R. 49).

naturally follows, therefore, that no concerns other than appellant and Remington are now engaged in making and selling tabulating cards in the regular course of business in this country (R. 53).

Although the practices pursued by appellant and Remington have been such as to prevent any competition between themselves or between them and third persons in the sale of tabulating cards, the commerce in such cards is important and substantial. Appellant, making 81% of all such cards manufactured, sells approximately 3,000,000,000 cards annually (R. 52). This means that Remington's sales, representing the remaining 19%, have been over 700,000,000 cards a year. Appellant derives a "substantial" profit from its card sales, the stipulation of facts not disclosing any more exact information (R. 53). Its gross receipts therefrom during the last ten years have averaged $3,192,700 a year (Appendix, *infra*, p. 31). These receipts have been approximately one-third of its average annual receipts over the same period from all of its tabulating machines, namely, $9,710,389 (*ib.*).

Approximately 4,303 tabulators, 4,106 sorters, and 8,412 punches owned by appellant are now in use in this country, but, counting the United States as a single user, the present users of such machines number only 3,304 (R. 49).

Less than 2% of appellant's cards are sold prepunched, the remaining 98% being punched by the users after purchase (R. 52–53).

ARGUMENT

I

APPELLANT HAS NOT SHOWN THAT THE TYING CLAUSES INCORPORATED IN ITS TABULATING MACHINE LEASES ARE NECESSARY TO PROTECT ITS GOOD WILL AND, IN ANY EVENT, SECTION 3 OF THE CLAYTON ACT CONTAINS NO IMPLIED EXCEPTION IN FAVOR OF TYING CLAUSES DESIGNED TO PROTECT THE LESSOR'S GOOD WILL

Section 3 of the Clayton Act makes it unlawful, in the course of interstate commerce, to lease machinery, "whether patented or unpatented", or to fix a price therefor, on the condition that the lessee shall not use supplies or other commodities of a competitor where the effect of such lease or condition "may be to substantially lessen competition or tend to create a monopoly in any line of commerce." Concerning the purposes of the Clayton Act and of Section 3, this Court said in *Standard Fashion Co.* v. *Magrane-Houston Co.*, 258 U. S. 346, 356:

> The Clayton Act sought to reach the agreements embraced within its sphere in their incipiency, and in the section under consideration to determine their legality by specific tests of its own * * *.

In *United Shoe Machinery Co.* v. *United States*, 258 U. S. 451, 459–460, which also involved Section 3, this Court said:

> The Sherman Act and the Clayton Act provide different tests of liability. This was determined in the recent case of *Standard*

Fashion Co. v. *Magrane-Houston Co., ante,* 346. In that case we pointed out that the Clayton Act was intended to supplement the Sherman Act, and within its limited sphere established its own rule.

Although appellant does not deny that its practices are within the express language of Section 3, the effect of its tying clauses in lessening competition deserves brief consideration. As to 81% of the commerce in tabulating cards, that represented by appellant's sales to its lessees, the tying clauses not merely have the effect of "substantially" lessening competition and of tending to a monopoly in that line of commerce; they eliminate *all* competition therein and give appellant an *actual* monopoly thereof. If the entire commerce in tabulating cards be considered as a unit, the removal of over 80% of such commerce from the field of competition is, by any conceivable test, a substantial lessening of competition. It is not the mere probable lessening of competition required by Section 3 (*Standard Fashion Co.* v. *Magrane-Houston Co., supra,* p. 357), but a certain lessening. By its tying clauses appellant may be said to have "built a Chinese wall against competitors." See *United States* v. *Corn Products Refining Co.,* 234 Fed. 964, 980 (D. C., S. D., N. Y.). Since no one will manufacture a product for which there is no market (*United States* v. *United Shoe Machinery Co.,* 264 Fed. 138, 163), not only is actual competition shut out but

potential competition is equally stifled. "Competition, actual or potential was the object of the Congressional solicitude." *Standard Fashion Co.* v. *Magrane-Houston Co.*, 259 Fed. 793, 797 (C. C. A., 1st).

Appellant suggests (Br., pp. 15–16), rather obliquely, that the competition which would exist but for the restrictive provisions would be "itself without real substance." It states that the United States has used Government-made cards, and it infers from this fact that the United States has in the past been unable to obtain satisfactory cards in the open market. This inference is totally unwarranted. Because the Government chose to make its own cards does not mean that, if it had sought to buy them commercially, it could not have found a company able and willing to make them at prices below those charged by appellant. It must be remembered, in this connection, that the use of cards other than those of appellant increased the rental which the United States paid for appellant's machines by 15%. Accordingly, to make the purchase of cards from others advantageous, they would have to be bought at prices sufficiently below those charged by appellant to offset in full the additional rental. Since the cost to lessees of the cards which they use in appellant's machines is on the average approximately ⅓ of the machine rentals which they pay (*supra*, p. 8), to absorb a 15%

excess rental would require a 45% reduction in the price of cards.[4] Furthermore, the agreement of March 4, 1931, between Remington and appellant's subsidiary, The Tabulating Machine Company,[5] barred Remington, the best equipped company to supply satisfactory competitive cards, from selling to appellant's lessees (R. 12).

Appellant's major contention, however, is that, unless it is allowed to continue its tying clauses, lessees will use in its machines cards not adapted thereto, such use will cause inaccurate results, lessees will erroneously attribute these unsatisfactory results to the machines rather than to defects in the cards, and appellant will therefore lose customer good will.

The first difficulty with this contention is the lack of any proof of the factual bases upon which it rests (except that it is established that use in the machines of cards not adapted to such use will cause inaccurate results). Since the contention is in the

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[4] Illustration. Appellant's cards used: Rental $1,000, cost of cards $333; total cost $1,333. Appellant's cards not used: Increased 15% rental, $150, which must be offset by saving in card purchases of 45% of $333, or $150.

[5] The charges of violation of the Sherman Act made in the present suit were based on this agreement, which contained many other covenants restricting competition (R. 4–7, 9–18). The agreement was cancelled after this suit was instituted and before trial (R. 46). Since The Tabulating Machine Company was later merged with appellant and since appellant assented to and guaranteed the agreement (R. 18–19), the agreement will hereafter be referred to as one between appellant and Remington.

nature of an affirmative defense, it must fail unless affirmatively proved. But the contention, with the exception just noted, is grounded upon nothing more solid than conjecture and speculation.

Even if the field of speculative possibilities is open to consideration, appellant's contention must nevertheless fail because the reasonable probabilities are the opposite of those suggested. The complex statistical work for which these tabulating machines are used, the large cost involved in using them, and the limited number of users (*supra*, pp. 5, 8) make it evident that practically all of the lessees are large business concerns such as insurance companies, railroads, other public utilities, banks, etc., or governmental bodies, federal, state, or municipal. It is only reasonable to infer that lessees of this type are fully informed as to the necessity for cards of precise specifications, that they will as a matter of self-interest purchase cards only after definite proof of their suitability, and that if perchance improper cards are purchased and used, the blame for resulting mistakes will not be erroneously attributed to the innocent machine. Appellant's suggestion (Br., p. 9) that lessees "will be unable to educate the local dealer in stationery" to the skill and experience necessary to produce proper cards, implying that lessees will purchase cards from these sources, seems so remote from actuality as to approach the absurd. Moreover, it is to be borne in mind that appellant's salesmen are

free to extol the superior merit of appellant's cards, a task simplified by the limited number of users.

While the local dealer in stationery cannot be expected to manufacture satisfactory cards, such manfacture, on the other hand, is not so difficult that appellant alone can succeed in the undertaking. The direct contrary has been stipulated (*supra,* p. 7) and, aside from this specific stipulation, is fully established. Suitable paper for the cards, including the sources from which appellant obtains its supply, are available (*supra,* p. 6), and the only remaining problems are cutting the paper to exact dimensions and testing it for impurities which would cause electrical contacts.[6] There is nothing to indicate that either problem would be beyond the resources of others if the field of competition were thrown open. In *Carbice Corporation* v. *American Patents Development Corp.,* 283 U. S. 27, 32, note 2, this Court quoted the following from Vaughan, Economics of Our Patent System.

> The very existence of such restrictions [tying clauses] suggests that in its absence a competing article of equal or better quality would be offered at the same or at a lower price.

The District Court seemed impressed by the fact that the Government Printing Office has been producing satisfactory cards which are in daily use in

[6] The stipulation contains three examples of appellant's cards (R. 61–63), which show their general form and character.

large quantities, the court saying that it could not "fairly be assumed that it would be difficult for commercial competitors" to achieve like success (R. 395). The cards now made by Remington are suitable if supplemented by an electrical test, in which matter Remington can, if necessary, follow the teachings of appellant's expired patent (*supra*, p. 7). Even if it should be assumed that Remington would be the sole successful competitor, this assumption would not negative the effect of appellant's tying clauses in substantially lessening competition. Competition is not dependent upon the number of competitors; a single strong competitor[7] familiar with all phases of a particular business may furnish just as effective competition as a number of weak and inexperienced competitors.

Consideration of appellant's purpose in requiring lessees to purchase its cards may throw some light upon the validity of its contention that this requirement is necessary to protect its good will. In *Chicago Board of Trade* v. *United States*, 246 U. S. 231, 238, this Court, speaking of the factors to be considered in determining whether an agreement unreasonably restrains trade, said:

> The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be

[7] From the standpoint of resources, appellant and Remington are approximately equal. Moody's *Industrial Manual*, 1935, pp. 1361, 2905.

> attained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences.

By its agreement of March 4, 1931, with Remington appellant supplemented the inherent restraints of its tying clauses by an agreement preventing even the possibility of competition. These two potential competitors agreed to incorporate tying clauses in all of their tabulating machine leases and each agreed not to sell tabulating cards to the other's lessees (R. 12). An *agreement* to maintain their respective monopolies in the supply of cards was certainly not necessary in order to protect good will.

Likewise the provision that the United States should pay 15% more rental whenever it used Government cards in appellant's machines cannot be explained as a mere effort to prevent the use in these machines of inferior cards, thereby protecting good will. The apparent purpose of the provision is to reimburse appellant for the profit which it would otherwise have derived from the sale of cards to the United States.

The remaining question raised by appellant's contention is whether, if there are facts to support it, it constitutes a defense to conduct which otherwise falls within the express prohibitions of Section 3.

In *Radio Corporation* v. *Lord*,[8] 28 F. (2d) 257 (C. C. A., 3rd), certiorari denied 278 U. S. 648, this question was decided in the negative. The defendant issued licenses under patents covering the electrical circuits of a radio receiving set, unpatented vacuum tubes being a part of such circuit, and required lessees to purchase from it exclusively all tubes necessary to make the sets initially operative. The court, in holding this requirement invalid under Section 3 of the Clayton Act, said (p. 260) that it was immaterial whether it would promote "uniformity, efficiency, and durability", because "excellence of product does not justify the evasion or violation of the provisions of the Clayton Act."

Due to the wide distribution of radios among all classes of the population, as compared with the type of big business concern using appellant's tabulating machines, it is obvious that there was a much more valid factual basis for urging the necessity of a tying clause to protect good will in the *Lord* case than there is here. The case cannot be distinguished, as appellant urges (Br., p. 15), upon the ground that inferior quality lay in the domain of "taste." Quality and dependability of recep-

[8] This was an appeal from a decree granting a preliminary injunction. On final hearing the District Court made the injunction permanent, 35 F. (2d) 962 (D. C., Del.), the Circuit Court of Appeals affirmed, 47 F. (2d) 606, upon the views expressed in its previous opinion, and this Court again denied certiorari, 283 U. S. 847.

tion are as important to the purchaser of a radio as accuracy of result to the lessee of a tabulating machine.

In *United Shoe Machinery Co.* v. *United States,* 258 U. S. 451, which held it was a violation of Section 3 for a lessee of patented shoe machinery to include in the lease provisions which had the effect of preventing lessees from using shoe machinery of a competitor, this Court said (p. 462):

> No matter how good the machines of the United Company may be, or how efficient its service, it is not at liberty to lease its machines upon conditions prohibited by a valid law of the United States.

The District Court in the same case, *United States* v. *United Shoe Machinery Co.,* 264 Fed. 138, 165 (D. C., E. D. Mo.), said that the weight of the evidence supported the contention of the defendants that it was economically advantageous to operate their machines in teams. But it held that the statute made it unlawful to deprive defendants' lessees, through tying clauses, of "freedom of choice", even though that choice might be exercised "mistakenly." It said:

> To enable manufacturers to use their own judgment, and exercise their choice based on that judgment, was beyond doubt one reason for the enactment of section 3 of the Clayton Act.

Appellant relies upon *Federal Trade Commission* v. *Sinclair Refining Co.,* 261 U. S. 463; *United*

States v. *United Shoe Machinery Co.*, 264 Fed. 138, *supra;* and *Pick Manufacturing Co.* v. *General Motors Corporation*, 80 F. (2d) 641 (C. C. A., 7th).

It is difficult to understand in what respect the *Sinclair* case is pertinent to the question whether tying clauses designed to protect the lessor's good will are impliedly excepted from Section 3. The proceeding in that case was brought under Section 5 of the Federal Trade Commission Act and Section 3 of the Clayton Act. The practice complained of was the leasing at nominal prices of underground tanks with pumps to retail dealers in gasoline, upon condition that the equipment should be used only with gasoline supplied by the lessor. The question of Clayton Act violation was disposed of upon the ground that the lessees were free to purchase gasoline, with or without a pump, from a large number of sellers and that a pump could be purchased for a comparatively small sum, so that the practice did not to any extent substantially restrain competition. Of the three passages from the Court's opinion quoted by appellant (Br., pp. 11–12), the last, which is the only one even remotely related to the question of good will, deals with the question whether the facts disclose a violation of the Federal Trade Commission Act.

In the *Shoe Machinery* case (264 Fed. 138) the District Court, although it invalidated the principal tying clauses there in question, sustained (p. 167) the validity of a clause providing: "The lessee shall obtain from the lessor exclusively * * *

all duplicate parts, extras, mechanisms, and devices of every kind needed or used in operating, repairing, or renewing the leased machinery, and the same shall form part of the leased machinery."[9] The court said that it found "nothing unreasonable in this provision", and it quoted the testimony of a witness that the parts, when placed in the machine, "become constituent parts of the machine itself, which is the United Company's own property." A tying clause limited to repairs or replacements which become integral parts of the lessor's machines does not, it would seem, provide that the lessee shall not "use or deal in" the goods of a competitor. Clearly such a clause does not relate to dealing and the word "use" appears to be employed in the statute in a like sense. If this interpretation is correct, not only was the clause in question not "unreasonable"; it did not come within the meaning of Section 3. The situation here is entirely different. The cards purchased by appellant's lessees become their absolute property and never thereafter revert to appellant. Nor do the cards, as was the situation in the *Shoe Machinery* case, ever become physically an integral part of the leased machines. Even the punching, necessary to make the cards ready for use in the machines, is done by the lessees (*supra,* p. 8).

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[9] The United States did not take a cross appeal in this case so that this portion of the District Court's decision was not passed on by this Court in *United Shoe Machinery Co.* v. *United States*, 258 U. S. 451.

In the *Pick* case (80 F. (2d) 641) General Motors or its subsidiary made contracts with its dealers in Chevrolet cars that they would use only General Motors parts in the repair of Chevrolet cars. There were two grounds of decision. One (p. 644) was that, since competition in the sale of replacement parts for automobiles had substantially increased during the time the restrictive provisions had been in force, the evidence did not show that these provisions would probably lessen competition substantially. The other ground of decision, upon which appellant relies, was based upon that portion of the District Court's decision in the *Shoe Machinery* case which has just been discussed. Whether or not this point is correctly decided, it is evident that the purchaser or owner of an automobile is seldom informed as to the name of the manufacturer whose parts are used in making repairs. He therefore does not have the information upon which to base an intelligent judgment as to where the blame lies if the car does not operate satisfactorily, and is likely in that event to attribute the fault to the car itself. In contrast, if appellant's lessees use in its machines cards of other manufacture, they can easily compare the results under such use with the results achieved by use of appellant's cards and can reach an informed judgment as to the cause of defective operation, should this occur. Another distinguishing feature is the difference be-

tween the class of customers involved: in the one case the general body of automobile users and in the other a limited number of important business organizations or governmental bodies accustomed, it must be assumed, to testing carefully the performance and quality of goods purchased for use in expensive machines.

II

SECTION 3 OF THE CLAYTON ACT DECLARES ILLEGAL CLAUSES WHICH TIE THE USE OF AN UNPATENTED ARTICLE TO A PATENTED MACHINE AND THE DISTRICT COURT CORRECTLY EXCLUDED THE PATENTS UPON WHICH APPELLANT RELIES. MOREOVER, THESE PATENTS DO NOT AUTHORIZE APPELLANT TO CONTROL THE CARDS USED IN ITS MACHINES

The stipulation of facts reserves the right to interpose objections upon grounds of relevancy (R. 47). The Government having exercised this right as to the patents referred to in the stipulation (R. 379), the District Court sustained the objection and held that no question of patent law, as such, was involved (R. 382).

Appellant deals (Br., pp. 16–21) solely with the question whether its patent rights are such as to permit it to bring suit for infringement if tabulating cards are used without its authority in its leased tabulating machines. It completely ignores the vital question whether the Clayton Act applies to and renders illegal the tying clauses in its leases even though under the patent law such an infringement suit would lie.

Before dealing with this question, we wish to correct the possibly misleading effect of appel-

lant's statements (Br., pp. 8, 19) that it had a patent "on the 80 column card" and one which "covers the card itself." Appellant's tabulating cards are not patented (R. 393). The patent to which appellant refers, No. 1,772,492, relates to the character of the hole in the card, the claimed invention being the use of a rectangular hole instead of a round one (R. 56, 192) and it therefore affects in any case only the 1.4% of appellant's 80-column cards which are sold pre-punched (R. 52–53).

United Shoe Machinery Co. v. *United States,* 258 U. S. 451, would seem to settle the invalidity of appellant's tying clauses irrespective of the extent of its patent rights under its machine patents and certain claims to the card as an element in the combination. One of the questions considered in that case was whether or not the decree in favor of defendants which was affirmed in *United States* v. *United Shoe Machinery Co.,* 247 U. S. 32, was *res judicata* of the validity of the tying clauses in the leases. The Court, in holding that it was not, said (p. 460) that in the former case, when the leases were attacked under the Sherman Act, "they were sustained as valid and binding agreements within the rights of holders of patents." In pointing out that the issue before the Court in the second case was different, the Court said (p. 460):

> The Clayton Act specifically applies to goods, wares, machinery, etc., whether

> "*patented or unpatented.*" This provision was inserted in the Clayton Act with the express purpose of preventing rights granted by letters patent from securing immunity from the inhibitions of the act.

The Court also said (p. 462):

> Congress has undertaken to deny the protection of patent rights to such covenants as come within the terms of the Clayton Act, and if the statute is constitutional, the sole duty of the court is to enforce it in accordance with its terms.

This Court likewise pointed out (p. 463) that "the franchise secured by a patent consists only in the right to exclude others from making, using, or vending the thing patented without the permission of the patentee" and that "the patent right confers no privilege to make contracts in themselves illegal, and certainly not to make those directly violative of valid statutes of the United States."

The decision necessarily means that tying clauses coming within the terms of Section 3 of the Clayton Act are invalid even though attaching such clauses to a license to use the patent would be within the patentee's rights under the patent law. There is particular reason to apply this ruling where the tying clause relates, as in the present case, to an unpatented commodity which is one of the elements named in a patented combination. *Radio Corp.* v. *Lord,* 28 F. (2d) 257, *supra,* involved precisely this situation and the tying clauses

as to the unpatented element in the combination were held invalid under the Clayton Act.

It is necessary only to analyze the consequences of a tying agreement in order to appreciate the vital distinction between the right to exclude others, through the enforcement of one's patent rights by means of a suit for infringement, and the contract right to exclude others obtained from a tying clause. In the absence of a tying clause, appellant, in order to enforce its asserted right to exclude other cards from use in its leased machines, would have to bring an infringement suit, in which the scope and validity of its patent claims would be tested. The effect of its tying clauses is to prevent the use of other cards in the leased machines irrespective of the validity or scope of its patents. The tying agreement has the effect of placing the particular patent rights which it asserts beyond judicial review, thus converting what the patent laws intend merely to be a *prima facie* right into an absolute one. This result is directly contrary to the policy of the patent laws, which contemplate that the validity and scope of patents shall be determined by the courts.

Appellant asserts (Br., p. 21) that the United States cannot collaterally attack the validity of its patents in this proceeding and it would undoubtedly take the same position in any litigation with private concerns involving a breach of its tying clauses. We therefore have the anomalous situa-

tion that appellant, setting up patent rights as a defense to provisions in its leases which would otherwise be invalid under the Clayton Act, at the same time asserts that the validity of its patents, and therefore the validity of this defense, cannot be made the subject of judicial inquiry.

The Government submits, finally, that under the patent law appellant could not sue as a contributory infringer one who supplied cards for use in its machines. It should be noted, in the first place, that there is no novelty in appellant's existing patents in respect of the card itself. The structure of the card and its function in opening electrical circuits is the same as in appellant's earlier patents, which have long since expired. It therefore appears that the card was improperly included as a specific element of the claims in the currently outstanding patents. Appellant has been making tabulating cards for at least 30 years and it is stipulated (R. 59):

> The defendant's machines have always used cards of various sizes made of paper; and these cards have always been provided with perforations, have always permitted the closing of electrical circuits through the holes therein so as to cause tabulating, sorting, etc., and have always operated in timed sequence with the machines.

For example, in patent No. 1,830,699 upon a tabulating machine, to which appellant particularly refers (Br., p. 17), the patent states that in the form of record card "selected for the purpose of

illustrating and describing" the invention, the index-point positions are denoted by printed figures arranged in groups "substantially as shown in my U. S. letters patent No. 677,214 and No. 777,209" (R. 87). Patent No. 677,214 is dated June 25, 1901 (R. 265).

It is submitted that *Carbice Corporation* v. *American Patents Development Corp.*, 283 U. S. 27, *supra*, makes it clear that appellant could not bring suit for contributory infringement against one furnishing cards for use in its machines. The invention there claimed was for a particular kind of package employing solid carbon dioxide in a new combination, solid carbon dioxide being an unpatented commodity. This Court, after asserting that if the patent was valid the owner could prohibit entirely the manufacture, sale, or use of its patented packages or could license them upon terms consistent with the limited scope of the patent monopoly, said (p. 31):

> But it may not exact as the condition of a license that unpatented materials used in connection with the invention shall be purchased only from the licensor; and if it does so, relief against one who supplies such unpatented materials will be denied. The limited monopoly to make, use, and vend an article may not be "expanded by limitations as to materials and supplies necessary to the operation of it."

With reference to the plaintiffs' attempt to distinguish certain prior decisions on the ground that

in the case before the Court the unpatented refrigerant was one of the necessary elements of the patented product and that it was a dynamic and not a passive element in the patented combination, this Court said (pp. 33–34):

> These distinctions are without legal significance. Infringement, whether direct or contributory, is essentially a tort, and implies invasion of some right of the patentee. * * * Relief is denied because the Dry Ice Corporation is attempting, without sanction of law, to employ the patent to secure a limited monopoly of unpatented material used in applying the invention.

See also *Motion Picture Patents Co.* v. *Universal Film Mfg. Co.*, 243 U. S. 502, 509, 510, 515.

Leeds & Catlin v. *Victor Talking Machine Co.*, 213 U. S. 325, upon which appellant relies, held that one who sold a disc for use in a machine embodying a patented combination of a sound record disc and a reproducing stylus was guilty of contributory infringement. The Court said (p. 330): "It is the disc that serves to distinguish the invention—to mark the advance upon the prior art." Furthermore, as the Court pointed out in *Leeds & Catlin* v. *Victor Talking Machine Co.*, 213 U. S. 301, 312–313, where it considered what constituted the invention, the disc was not only structurally new but, by reason of its changed structure, it operated differently with its co-acting element. In the present case, as previously indicated (*supra*,

p. 26), the card is not structrually new and the improvements which form the basis of the existing patents do not reside in the combination but in the structural details of the machine alone.

In *McGrath Holding Corp.* v. *Anzell*, 58 F. (2d) 205 (C. C. A., 2d), the court in holding a combination patent invalid said (p. 206), "Since this combination was old, the inventor of a new form of one element cannot claim the entire combination, even though he includes his new form of the element."

In the *Carbice* case (283 U. S. 27, 34) the Court distinguished *Leeds & Catlin* v. *Victor Talking Machine Co.*, 213 U. S. 325, *supra*, upon the ground that the latter was an ordinary case of contributory infringement. In the instant case there are present the elements which led this Court to a different conclusion in the *Carbice* case than that reached in the *Leeds & Catlin* case.

CONCLUSION

It is respectfully submitted that the decree of the District Court should be affirmed.

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APPENDIX

Appellant's receipts from tabulating cards and tabulating machines [1]

Year	Tabulating cards	Tabulators	Sorters	Punches
1926	$2,613,000	$4,174,577	$803,080	$223,263
1927	2,633,000	4,858,028	1,004,727	347,461
1928	2,887,000	5,517,399	1,133,293	494,086
1929	3,595,000	6,633,134	1,360,316	743,727
1930	3,947,000	7,779,295	1,602,153	1,067,531
1931	3,444,000	8,361,560	1,731,288	1,428,803
1932	2,775,000	8,033,700	1,652,474	1,582,115
1933	2,841,000	7,223,607	1,503,132	1,774,065
1934	3,392,000	8,080,333	1,711,037	2,380,903
1935	3,800,000	9,033,807	1,835,680	3,029,323
Totals	31,927,000	69,695,440	14,337,180	13,071,277
Average	3,192,700	6,969,544	1,433,718	1,307,127

[1] Receipts from tabulating cards (R. 53) and from tabulating machines (R. 72A); 1935 receipts computed upon basis of 4/3rds of receipts shown for first 9 months of 1935.

Average receipts from tabulating machines

Tabulators	$6,969,544
Sorters	1,433,718
Punches	1,307,127
Total	9,710,389

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